

**UNIVERSITY OF
WASHINGTON
METRO TRACT REPORT:
2003 UPDATE**

REPORT 03-7

**REPORT
DIGEST**

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STATE OF WASHINGTON

JOINT LEGISLATIVE AUDIT AND
REVIEW COMMITTEE

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Background

The State of Washington owns the Metropolitan Tract, a parcel of office and hotel properties, occupying approximately 11 acres, in downtown Seattle. The University of Washington (UW) has developed and managed the Tract, which generates income for the University in excess of funds needed for operations and maintenance. 1999 legislation (RCW 28B.20.382) facilitated the Legislature's role in appropriating this Tract income for debt service and construction of other capital projects at the UW. That legislation also directs the UW to report to the Joint Legislative Audit and Review Committee (JLARC), every two years, on its management of the Tract. The UW's 2003 report follows, responding to questions raised from JLARC's Executive Committee (Appendix 1). The next UW report will be due in the 2005 Legislative Session.

Overview

JLARC's previous reviews noted that the Metropolitan Tract generates significantly less income to the University, relative to the Tract's asset value, than does the neighboring Union Square property for the State Investment Board. A major reason is because of the terms of the lease between the UW and UNICO Properties, Inc., the firm that manages much of the Tract for the UW. This lease was initiated in the 1950s, renewed in the late 1970s, and will expire in 2014. JLARC continues to recommend that this current lease arrangement **not** be renewed when it expires in 2014.

Focus of 2003 Report

The attached UW report responds to JLARC's request to address nine topics of concern. Following are JLARC staff comments on that report:

- **Funds Available from Metro Tract for other UW Capital Projects.** For the past several biennia, the Tract has generated approximately \$8 million per year in earnings, over and above operating and capital costs, for the UW Building Account. UW anticipates this pattern will continue in 2003-05. The UW's report also indicates that approximate one-half of the Metro Tract earnings in 2003-05 will go toward paying the bonded portion of construction costs of the new Law School. The UW did not estimate the income likely to be transferred to the UW Building Account beyond 2003-05.

The UW's 10-year Tract financial plan suggests that sufficient future income may not be generated to continue annual transfers of \$8 million to the UW Building Account in the 2005-07 biennium. A combination of lower revenue (attributable to the current economic slump) and higher capital costs (attributable to aging buildings) leads to this diminished income picture. This financial plan anticipates improving cash flow beyond 2005-07, with optimistic assumptions for revenue growth.

- **Tract Value and Earnings.** UW estimates that its interest in the Metropolitan Tract is currently worth \$192 million. The Tract generated \$18 million in income in FY 2002, with an estimated return on investment of 9.4 percent, higher than a national index of commercial real estate investments. The 2003 UW report indicates that the value of the Metropolitan Tract properties **declined** by 11.3 percent in calendar year 2002 (previously declining by 11.9 percent in 2001). This decline in value has considerably exceeded that of a commonly used index of commercial real estate valuation.

The estimated 9.4 percent return on investment may be somewhat overstated. The calculated return is based on the estimated value of the Tract, which in turn reflects the projected net income to be generated by the Tract, discounted to present value by 10.25 percent. That discount rate assumption appears somewhat high. The effect of such a discount rate lowers the current value of an asset and, thus, increases the estimated return on that asset. Additionally, the UW's projections of both future operating and capital expenditures also seemed high, further reducing future net income and lowering the current valuation of the Tract.

- **Operations and Maintenance Expenditures.** The Legislature has been concerned about on-going maintenance and preservation efforts and expenditures for state facilities. Under the lease arrangements, UNICO is responsible for operations and maintenance costs, while UW is responsible for capital costs. UNICO and the University provided data on operating repair and maintenance expenditures per square foot from 1995 through 2002. These figures are within range of a benchmark—that of the Building Owners and Managers Association (BOMA) of Seattle.

The UW report also mentions on-going physical inspections of the properties to note those maintenance, modernizing and capital development efforts that require addressing. For those capital cost areas that fall under the University's responsibility, the University proposes these to its Board of Regents. UW's financial plan anticipates making capital expenditures averaging \$5 per square foot per year through FY 2014.

- **Future Plans.** The University notes that it will not renew the lease in its current form at its expiration in 2014. However, using a third-party manager/developer is one option under continuing consideration. In the meantime, other development or redevelopment scenarios and opportunities are always under review.

This report on the University of Washington's management of the Metro Tract illustrates the patterns of financial returns from this public asset. Legislative concern that a portion of the earnings should go to debt service on that portion of the Law School's costs funded through bonds is demonstrated in this report. The University has also discussed in general terms alternative management scenarios in the post-2014 period. More details can be explored in future biennial reports.